

REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE INFORMATION OF MBHASHE LOCAL MUNICIPALITY FOR THE YEAR ENDED 30 JUNE 2008

Introduction

1. I was engaged to audit the accompanying financial statements of the Mbhashe Local Municipality ("the municipality") which comprise the statement of financial position as at 30 June 2008, statement of financial performance, statement of changes in net assets and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages [xx] to [xx].

Responsibility of the accounting officer for the financial statements

2. The municipal manager is responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting determined by the National Treasury, as set out in accounting policy note 1 and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) ("MFMA") and the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA). This responsibility includes:
 - designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
 - selecting and applying appropriate accounting policies
 - making accounting estimates that are reasonable in the circumstances.

Responsibility of the Auditor-General

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004), my responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with the International Standards on Auditing and General Notice 616 of 2008, issued in Government Gazette No. 31057 of 15 May 2008. Because of the matter discussed in the Basis for disclaimer of opinion paragraphs, however, I was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.
4. Paragraph 11 *et seq.* of the Statement of Generally Recognised Accounting Practice, GRAP 1 *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

Basis of accounting

5. The municipality's policy is to prepare financial statements on a comprehensive basis accounting as determined by the National Treasury, as set out in accounting policy note 1 of the annual financial statements.

Basis for disclaimer of opinion

Revenue – service charges and rates

6. Service charges were disclosed as R2.6 million on the face of the statement of financial performance while the trial balance amount is R702 858. Management was unable to provide a comprehensive explanation or reconciliation of the above variance. The general ledger accounts could not be provided by the municipality. Daily cash takings were not banked daily and under banking amounting to R24 590 was noted. Reconciliations of cash received and cash deposited were not performed. A valuation roll, customer statements, invoices and billing reports were not provided by the municipality.
7. Furthermore, the municipality's rates policy and tariff policy were not provided.
8. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable satisfy myself as to the completeness, accuracy and occurrence of service charge revenue amounting to R2.6 million, as disclosed in note 10 to the annual financial statements.

Revenue – rental of facilities and equipment

9. Rental of facilities and equipment was disclosed as R198 313 on the face of the statement of financial performance, while the trial balance amounts to R251 899. Management was unable to provide a comprehensive explanation or reconciliation of the above variance. The general ledger accounts could not be provided by the municipality. Rental agreements, as well as details of municipal housing rentals, were requested from the municipality, but were not provided.
10. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable satisfy myself as to the completeness, accuracy and occurrence of rental income relating to facilities and equipment amounting to R198 313, as disclosed in the annual financial statements.

Interest earned on external investments

11. Interest earned – external investments was disclosed as R1.3 million on the face of the statement of financial performance. The trial balance amounts to R16 875. Management was unable to provide a comprehensive explanation or reconciliation of the above variance. The general ledger accounts could not be provided by the municipality.
12. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, accuracy and occurrence of revenue earned on external investments amounting to R1.3 million, as disclosed in the annual financial statements.

Government grants and subsidies

13. In terms of the Division of Revenue Act, 2007 (Act No. 1 of 2007) (DoRA), an amount of R73.9 million should have been received during the year. A reconciliation or schedule detailing grant funding received was not provided. The statement of financial performance reports Government Grants and Subsidies as R67.1 million.

Grant income per the trial balance amounts to R68.3 million. The reconciliation of this balance was not provided. Furthermore an adequate explanation of the differences was not provided.

14. DORA reflects an amount of R37.6 million as equitable share for the current financial year. An amount of R45.2 million has been disclosed in the notes to the annual financial statements. The municipality was unable to provide an adequate explanation for the difference. The municipality has also not disclosed the portion of equitable share utilised to subsidise services provided to indigent debtors.
15. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, accuracy and occurrence of Government grants and subsidies amounting to R67.1 million, as disclosed in the annual financial statements.

Other income

16. Other income of R1.9 million per the annual financial statements could not be reconciled to the trial balance amount of R1.8 million. No supporting documentation was provided by the municipality.
17. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to completeness, accuracy and occurrence of Other income amounting to R1.9 million, as disclosed in note 12 in the annual financial statements.

Employee costs

18. Monthly payroll reconciliations are not prepared, therefore it was not possible to determine whether payroll costs for salaried employees were completely and accurately recorded. Wage registers are not maintained at the municipality for wage workers and supporting documentation could not be obtained for payments made to casual workers, therefore it was not possible to determine whether wage expenditure was correctly accounted for.
19. The municipality was unable to provide all supporting documents requested for leave taken by all employees, as well as leave paid out to employees, therefore it was not possible to determine whether leave taken by employees was completely and accurately recorded.
20. Documented working regulations of the municipality, the collective agreements entered into between the municipality and its employees regarding overtime, the overtime policy and a listing of overtime payments made to senior management was requested, but could not be provided by the municipality.
21. Supporting documentation for retirement benefit information as disclosed in note 26 to the annual financial statements was not provided. Furthermore the disclosure was not in compliance with IAS 19 (AC 116): Employee benefits.
22. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable satisfy myself as to completeness, occurrence and accuracy of Employee costs amounting to R22.8 million as disclosed on the statement of financial performance.

General expenses

23. Supporting documentation relating to repairs and maintenance, grants and subsidies paid and general expenses of R3.2 million was not provided. The repairs and maintenance, grants and subsidies paid and general expenses balance could not be reconciled to the trial balance amount of R11.9 million. Management was unable to provide a comprehensive explanation or reconciliation of the above variance. Furthermore a general ledger and a detailed listing of leases was not provided.
24. Tender documentation, bid documentation, tender evaluation reports, tender registers and details of payments made to consultants was not provided. This is due to the fact that the municipality does not have a supply chain management function.
25. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the occurrence and accuracy of repairs and maintenance, grants and subsidies paid and general expenses amounting to R16 million as reported in the statement of financial performance.

Funds and reserves

26. I was unable to verify the opening balance of the accumulated surplus due to the disclaimer of audit opinion issued in the prior year. Misstatements which occurred in the prior year have not been corrected. Consequently, I was unable to satisfy myself as to valuation of the accumulated surplus of R82.7 million as reported in the statements of financial position and changes in net assets.
27. I was unable to verify the opening balance of the government grant reserve due to the disclaimer of audit opinion issued in the prior year. A fixed asset register was not submitted, therefore the valuation of property, plant and equipment reported in the statement of financial position could not be verified and therefore the transfers for additions, disposals and depreciation of property, plant and equipment between the accumulated surplus and the government grant reserve could not be confirmed. I was therefore unable to satisfy myself as to the valuation of the government grant reserve of R9.7 million as reported in the statements of financial position and changes in net assets.

Creditors

28. The accrual for leave of R1 million disclosed in note 2 to the annual financial statements is based on the leave records of the municipality, which were found to be inadequate. Instances were found where leave recorded as taken was not supported by leave applications and documentation authorising the absence from work. Attendance registers for some employees were not submitted.

Furthermore both the accrual for leave pay and provision for performance bonuses have not been reassessed in the current year. It is not the municipality's policy to pay performance bonuses, thus there should not be a provision for performance bonuses. However, the municipality does pay annual bonuses in the form of a 13th cheque regardless of performance which have not been accrued for.

29. Creditors' reconciliations are not prepared. Expenses amounting to R667 944 were not correctly accrued for at year end. The creditors balance per the trial balance of R140 951 was not reconciled to the balance per the annual financial statements. The municipality's records and systems did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, existence and valuation of the Creditors balance of R2.2 million as disclosed in note 2 to the financial statements.

Unspent conditional grants and receipts

30. Unspent conditional grants and receipts are disclosed as R6.3 million in the statement of financial position. This balance could not be reconciled to the trial balance. Opening balances per note 3 does not reconcile to the 2007 comparative figures per the statement of financial position. Management was unable to provide an explanation for these differences. Consequently, I was unable to satisfy myself as to the completeness, existence and valuation of the Unspent conditional grants and receipts balance of R6.3 million as disclosed in note 3 to the financial statements.

VAT

31. VAT due to the South African Revenue Services ('SARS') of R1 million is disclosed in note 4 to the financial statements. This balance has not been reconciled to the VAT 201 returns submitted to SARS, and as a result no documentation is available to support the balance. SARS reports the VAT balance due to the municipality as R 21.9 million (in respect of the 2004/ 2005 financial year to the 2007/ 2008 financial year).

32. Tax invoices amounting to R4 million did not reflect the VAT registration number of the municipality as required by the VAT Act.

33. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, existence and valuation of the VAT creditor of R1 million.

Property, plant and equipment

34. A fixed asset register was not provided. Furthermore, depreciation of R2.8 million was reported in the statement of financial performance. This amount could not be traced to the trial balance. Management was unable to provide the basis of calculation of this amount.

35. The municipality's assets records and systems did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the valuation, accuracy, existence, completeness and rights and obligation of assets to the value of R63.9 million as disclosed in the statement of financial position.

36. Appendix A to the annual financial statements discloses an analysis of amounts disclosed as property, plant and equipment. Depreciation of R2.8 million and capital additions of R13.1 million could not be traced to the trial balance or supporting documentation. The opening balances for each category of fixed assets could not be traced to the prior year annual financial statements.

37. GAMAP 17.15 states that it is appropriate to allocate the total expenditure on an asset to its component parts and account for each component separately when the component asset has different useful lives or provide benefits to the entity in a different pattern, thus necessitating the use of different depreciation rates and methods. The municipality does not separate its fixed assets in terms of their individual components. Thus GAMAP 17 was not complied with.

Consumer debtors

38. Consumer debtors of R6.5 million per note 7 to the financial statements could not be traced to the debtors' age analysis. A reconciliation was not prepared by the municipality. Customer statements, invoices and billing reports were not provided.
39. The basis for calculating the provision for bad debts per note 7 to the financial statements was not provided by the municipality. This provision could not be agreed to the trial balance.
40. Bad debts of R5.9 million were written off during the year per the statement of financial performance. The calculation of this amount could not be traced to supporting documentation.
41. The municipality's records did not permit the application of alternative audit procedures . Consequently, I was unable satisfy myself as to the completeness and valuation of the Consumer debtors balance of R6.5 million and the completeness and valuation of the Provision for bad debts of R6.4 million and as disclosed in note 7 to the annual financial statements.

Other debtors

42. Other debtors of R111 358 could not be traced to the trial balance or to supporting documentation.
43. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness and valuation of the Other debtors balance of R111 358 as disclosed in note 8 to the annual financial statements.

Cash and cash equivalents

44. Outstanding cheques of R3.3 million, included in the reconciliation between bank statements and the cash book were found to have been outstanding at 30 June 2007 and are thus invalid reconciling items as they are stale and should be reversed to Creditors.
45. A First National Bank account reflecting a balance of R635 645 at 30 June 2008 is included in the Cash and cash equivalents balance of R37.9 million in the annual financial statements. This bank account was closed during the 2006/ 2007 financial year. Management were unable to provide an explanation for this balance.
46. The municipality's records did not permit the application of alternative audit procedures. Consequently, I was unable to satisfy myself as to the completeness, existence and valuation of the Cash and bank balance of R37.9 million as disclosed in note 9 to the annual financial statements.

Irregular expenditure

47. In terms of Government Notice R1224 published in Government Gazette No. 29447 of 1 December 2006, the upper limits of the total remuneration package of the executive mayor may include a motor vehicle allowance. In addition, the municipality may also make an official vehicle available to the mayor provided it is used for official purposes. No procedures or policies have been adopted by the municipality to ensure that the mayoral vehicle is used only for official business or to identify private usage. It was not possible to determine the extent of the irregular expenditure incurred.
48. The municipality was requested to provide details of a mayoral residence provided at no cost to the mayor. No information regarding this was received. Such a benefit does not fall within the framework of the Political Office Bearers Act, 1998 (Act No. 20 of 1998) and would constitute a violation of section 167 of the Municipal Finance Management Act ('MFMA'). As a result, the market related rental of such a residence would constitute irregular expenditure if the cost of such housing was not recovered from the mayor. The full extent of the irregular expenditure could not be determined.
49. In terms of section 11(1) of the MFMA, only the municipal manager, chief financial officer or another delegated official may authorise the withdrawal of municipal funds from the municipality's bank accounts. Unidentified payments amounting to R508 357 were processed from the main bank account bank statement. Municipal officials were unable to explain these payments. As not all bank statements for the year were presented, I am unable to quantify the total amount relating to irregular payments.
50. Credit card statements relating to the Municipal manager, Chief financial officer, Speaker and Mayor were requested, but were not provided by the municipality. Any expenditure incurred relating to these credit cards is thus considered irregular.
51. Regulation 12 of the Supply Chain Management Regulations specifies the levels of expenditure at which verbal and/or written quotes should be obtained. The municipality did not follow this regulation when incurring expenditure amounting to R150 65. Furthermore, an asset requisition of R89 275 was not authorized by the municipal manager as required by the municipality's procurement policy. This expenditure is thus considered irregular.
52. Expenditure amounting to R323 494 was not authorised by the designated official in terms of section 65 of the MFMA . This expenditure is thus considered irregular.
53. The municipality did not disclose irregular expenditure described above as prescribed by section 125(2)(d) of the MFMA.

Fruitless and wasteful expenditure

54. Two months of salary payments totalling R11 928, were made to two employees after termination of employment. This constitutes fruitless and wasteful expenditure.
55. Section 11(1) of the MFMA prescribes the purposes for which expenditure may be incurred by the municipality. Private telephone calls by employees and officials are

not included in such allowed expenditure. No system was in place to monitor and recover the cost of private telephone calls made by employees. It was not possible to determine the extent of this fruitless and wasteful expenditure.

56. The municipality did not disclose fruitless and wasteful expenditure described above as prescribed by section 125(2)(d) of the MFMA.

Related parties

57. The municipality has not documented and implemented adequate procedures to identify related parties, as well as any transactions and balances with such related parties. Councillors are required to complete declarations if interest in outside companies, however these were found to be incomplete.
58. Consequently, it was not possible to determine whether the information contained in the register of interests in contracts or the related party disclosure in the financial statements was complete and accurate.

Councillors' arrear consumer accounts

59. In terms of section 124(1)(b) of the MFMA, the notes to the annual financial statements of a municipality must include particulars of any arrears owed by individual councillors to the municipality for services and which at any time during the relevant financial year were outstanding for more than 90 days, including the names of those councillors. Councillors' arrear consumer accounts are not disclosed in the annual financial statements. Therefore it was not possible to verify the completeness and accuracy of the disclosure of councillors' arrear consumer accounts.

Disclaimer of opinion

60. Because of the significance of the matters described in the Basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements of the Mbhashe Local Municipality. Accordingly, I do not express an opinion on the financial statements.

OTHER MATTERS

I draw attention to the following matters that are ancillary to my responsibilities in the audit of the financial statements:

Internal control

61. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The paragraphs below depict the root causes of the matters indicated, as they relate to the five components of internal control.

Reporting item	Control environment	Assessment of risks	Control activities	Information and communication	Monitoring
Basis for disclaimer of opinion					
Revenue – service charges	X				
Rental of facilities and equipment	X				
Investment interest			X		
Government grant and subsidies			X		
Other income	X				
Employee costs		X			
General expenses			X		
Funds and reserves	X				
Creditors		X			
Unspent conditional grants and receipts			X		
VAT	X				
Property, plant and equipment	X				
Consumer debtors	X				
Other debtors	X				
Cash and cash equivalents			X		
Irregular expenditure	X				
Fruitless and wasteful expenditure			X		
Related parties	X				
Councillors' arrear consumer accounts			X		

Non-compliance with the Municipal Finance Management Act

62. Section 9(b): Evidence of bank account information submitted to provincial treasury and the Auditor-General was not provided.
63. Section 65(2)(e): Invoices to the value of R5.3 million were not paid within thirty days.
64. Section 64(3): Long outstanding balances from other Organs of State have not been communicated to National Government.
65. Section 67: Details of funds transferred to an organisation or body outside any sphere of government (otherwise than in compliance with a commercial or other business transaction) were not.
66. Section 126(1): The municipality did not submit annual financial statements within two months of the 30 June 2008 financial year end.
67. Supply Chain Management regulations, Regulation 2(1): The municipality does not have a procurement policy in place.
68. Supply Chain Management regulations, Regulation 23(c): The municipality does not have a contract register in place to record all bids received.

Non-compliance with the Unemployment Insurance Fund Contributions Act

69. Unemployment Insurance Fund contributions for employees was calculated at 0.95% instead of 1%. Unemployment Insurance Fund contributions are not deducted from councillors' salaries. This is contrary to the Unemployment Insurance Fund Contributions Act 4 (Act 4 of 2002).

Fraud risk

70. There is no approved fraud prevention plan at the municipality. This increases the risk of fraud and error within all major business cycles.

Performance Management System

71. Sections 39 and 40 of the Municipal Systems Act, 2000 (Act No.32 of 2000) require the development of a Performance Management System and the establishment of mechanisms to monitor and review the Performance Management System. There is insufficient evidence that the council complied with these statutory requirements during the period under review.

Matters of governance

72. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of certain key governance responsibilities, which I have assessed as follows:

Matter of governance	Yes	No
Audit committee		
• The municipality had an audit committee in operation throughout the financial year.		X

Matter of governance	Yes	No
<ul style="list-style-type: none"> The audit committee operates in accordance with approved, written terms of reference. The audit committee substantially fulfilled its responsibilities for the year, as set out in Section 166(2) of the MFMA. 		X
Internal audit		
<ul style="list-style-type: none"> The municipality had an internal audit function in operation throughout the financial year. The internal audit function operates in terms of an approved internal audit plan. The internal audit function substantially fulfilled its responsibilities for the year, as set out in Section 165(2) of the MFMA. 		X
Other matters of governance		
<ul style="list-style-type: none"> The annual financial statements were submitted for audit as per the legislated deadlines in section 126 of the MFMA. The annual report was submitted to the auditor for consideration prior to the date of the auditor's report. The financial statements submitted for audit were not subject to any material amendments resulting from the audit. No significant difficulties were experienced during the audit concerning delays or the unavailability of expected information and/or the unavailability of senior management. The prior year's external audit recommendations have been substantially implemented. 		X
Implementation of Standards of Generally Recognised Accounting Practice (GRAP)		
<ul style="list-style-type: none"> The municipality submitted an implementation plan, detailing progress towards full compliance with GRAP, to the National Treasury and the provincial treasury before 30 October 2007. The municipality substantially complied with the implementation plan it submitted to the National Treasury and the relevant provincial treasury before 30 October 2007, detailing its progress towards full compliance with GRAP. The municipality submitted an implementation plan, detailing further progress towards full compliance with GRAP, to the National Treasury and the relevant provincial treasury before 31 March 2008. 		X

Report on performance information

73. I was engaged to audit the performance information.

Responsibility of the accounting officer for the performance information

74. In terms of section 121(3)(c) of the MFMA, the annual report of a municipality must include the annual performance report of the municipality prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

Responsibility of the Auditor-General

75. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.
76. In terms of the foregoing, my engagement included performing procedures of an audit nature to obtain sufficient appropriate evidence about the performance information and related systems, processes and procedures. The audit procedures selected depend on the auditor's judgment.
77. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

Audit findings (Performance information)

Non-compliance with regulatory requirements

No reporting on performance information

78. The municipality has not reported performance against pre-determined objectives as required by section 121(3)(c) of the MFMA.

Existence and functioning of a performance audit committee

79. The municipality did not appoint and budget for a performance audit committee, neither was another audit committee utilised as the performance audit committee.

APPRECIATION

80. The assistance rendered by the staff of the Mbhashe Local Municipality during the audit is sincerely appreciated.

East London
30 January 2008

